

Chapter 11
Category 11g
Gross Rent(s) Exceed Tax Credit Limits

Definition

This category is used to report noncompliance with the rent restrictions outlined in IRC §42(g)(2). A unit qualifies as an LIHC unit when the gross rent does not exceed 30 percent of the imputed income limitation applicable to such unit under IRC §42(g)(2)(C). The income limit for a low-income housing unit is based on the minimum set-aside election made by the owner under IRC §42(g)(1).

Items to consider when determining whether the rent is correctly restricted include services provided, revisions to HUD income limits, rent calculation methods, changes in the tenant's income, Section 8 tenants, Rural Housing Service (formerly FmHA) rents, supportive services, and deep rent skewing.

**Fees -
Provision of
Services**

Units may be residential rental property notwithstanding the fact that services *other than housing* are provided. However, any charges to low-income tenants for services that are not optional generally must be included in gross rent (Treas. Reg. 1.42-11). A service is optional when the service is not a condition of occupancy and there is a reasonable alternative. Charges for non-optional services such as a washer and/or dryer hookup fee and built-in/on storage sheds (paid month-to-month or a single payment) would always be included within gross rent. No separate fees should be charged for tenant facilities (i.e., pools, parking, recreational facilities) if the costs of the facilities are included in eligible basis. *Assuming they are optional*, charges such as pet fees, laundry room fees, garage, and storage fees may be charged in addition to the rent; i.e., they are not included in the rent computation.

**Fees –
Condition of
Occupancy**

Under Treas. Reg. §1.42-11(a)(3), the cost of services that are required as a condition of occupancy must be included in gross rent even if federal or state law required that the services be offered to tenants by building owners.

1. Refundable fees associated with renting an LIHC unit are not included in the rent computation. For example, security deposits and fees paid if a lease is prematurely terminated¹ are one-time payments that are not considered in the rent calculation.
2. Required costs or fees, which are not refundable, are included in the rent computation. Examples include fee(s) for month-to-month tenancy and renter's insurance.

Fees for preparing a unit for occupancy must not be charged; owners are responsible² for physically maintaining LIHC units in a manner suitable for occupancy.

¹ Leases commonly include fees for early termination of the rental agreement. The fact that the lease contains terms for this contingency is not indicative of transient use.

² See IRC §42(i)(3)(B)(i) and Treas. Reg. §1.42-5(g).

**Fees –
Application
Processing**

Application fees may be charged to cover the actual cost of checking a prospective tenant's income, credit history, and landlord references. The fee is limited to recovery of the actual out-of-pocket costs. No amount may be charged in excess of the average expected out-of-pocket costs of checking tenant qualifications at the project. It is also acceptable for the applicant to pay the fee directly to the third party actually providing the applicant's rental history. See PLR 9330013, Issue 1, for an example.

**Changes to
HUD Income
Limits**

Rents must be calculated using HUD³ income limits. The lowest rents owners will be required to charge (gross rent floor) are based on the income limits in effect when the building is allocated credits, unless the owner elects⁴ (and notifies the housing credit agency of the election) to treat the rent floor as taking effect on the date the building is placed in service. This rule applies to properties receiving credit allocations or determination letters under IRC §42(m)(2)(D) after October 6, 1994. For allocations and determination letters after 1989 and before October 7, 1994, owners and state agencies may use a date based on a reasonable interpretation of IRC §42. Before 1990, the gross rent floor took effect at the time the building was placed in service. See IRC §42(g)(2)(A). If the income limits increase, there is no noncompliance as long as the rents are at or below the maximum rents in effect at that time. However, if the income limits are reduced, the maximum rent charged, as well as the gross rent floor, should be reviewed.

Example 1: HUD Income Limit Reduced (Credit Allocation Date)

The owner elected the 40/60 minimum set-aside on Form 8609. HUD issues reduced income limits effective 1/1/2000. The revised maximum 60% gross rent is \$400, which is *below* the calculated maximum rent floor of \$500 in effect at the time the owner received the credit allocation. The owner has been charging \$450 rent and a \$50 utility allowance. There is no noncompliance; owner may rely on his gross rent floor and continue to charge \$500 in total rent.

Example 2: HUD Income Limit Reduced (Placed-in-Service Date)

The owner elected the 40/60 minimum set-aside on Form 8609 and elected to treat the rent floor as taking effect on the date the building was placed in service on July 12, 1999. HUD then issued reduced income limits effective 1/1/2000. The revised maximum 60% gross rent is \$400, which is *above* the calculated rent floor of \$300 at the time the owner placed the building in service. The owner *may* charge rent of \$350 and a \$50 utility allowance, for a total of \$400.

**Rent
Calculation
Methods**

Pre-1990: Gross rent for properties receiving tax credit allocations or bond-financed buildings placed in service before January 1, 1990 and for which the election⁵ to determine rents based on number of bedrooms was not made, may not exceed thirty percent (30%) of the HUD-determined median income limit adjusted for the actual number of people in the household for the area in which the property is located. Under

³ Owners have 45 days to implement revised income limits after they are published by HUD or HUD's effective date for the new list, whichever is later. See Rev. Rul. 94-57, 1994-2 C.B. 5.

⁴ See Rev. Proc. 94-57, 1994-2 C.B. 774.

⁵ See Rev. Proc. 94-9, 1994-1 C.B. 555.

this method, the maximum allowable rent varies with the number of individuals occupying the unit. This is the method used prior to the Revenue Reconciliation Act of 1989.

Post-1989: For properties receiving tax credit allocations or placing bond-financed buildings in service after December 31, 1989⁶ and for pre-1990 properties subject to the bedroom election under Rev. Proc. 94-9, maximum gross rents are computed based on the number of bedrooms in the unit. Units with no separate bedroom are treated as being occupied by one person and units with separate bedrooms are treated as being occupied by 1.5 persons per each separate bedroom. Note: The bedroom method calculation may be applied only for households moving into units *after* the date the bedroom election was made. Units with households living in the property before the date of the election will continue to be charged rents based on the number of family members actually living in the unit until such time as a turnover in occupancy occurs.

Example 1: Rent Exceed Limit - Bedroom Election

Assume credits were allocated in 1988 and the owner elected by February 7, 1994 to use the bedroom election to calculate rent. A one-person household moved into a 2-bedroom unit on February 1, 1994 and paid the maximum one-person gross rent of \$300 and a \$50 utility allowance. Following the bedroom election, the owner raises this household's rent to the maximum two-bedroom rent of \$500, plus a \$50 utility allowance, for a total rent of \$550.

This is not allowable because the household moved into the unit before the date of the election and the rent of \$550 is over the allowable maximum. Rent in this unit may only be changed to the bedroom calculation method on the date a new household moves in. The owner must immediately reduce the rent charge to \$300 rent, plus a \$50 utility allowance. Date of correction is the date of the lease amendment.

Tenant Income Rises Above Limit

A unit shall continue to be treated as a low-income unit if the income of the occupants initially met the income limitation and the unit continues to be rent-restricted⁷. The owner may also be subject to the Available Unit Rule and the Vacant Unit Rule. (See chapters 14 and 15.)

Section 8 Tenants

The gross rent limit applies only to payments made directly by the tenant. Any rental assistance payments made on behalf of the tenant, such as through section 8 of the United States Housing Act of 1937 or any comparable Federal rental assistance, are not included in gross rent. Congress further intended that any comparable state or local government rental assistance not be included in gross rent. See IRC §42(g)(2)(B)(i) and the General Explanation of the Tax Reform Act of 1986.

Example 1: Household Portion of Rent is Below Limit

⁶ IRC §42(g)(2)(C)

⁷ IRC § 42(g)(2)(D)(i).

A Section 8 household moved into a unit on January 1, 2000; the maximum LIHC gross rent is \$500 and market rate is \$600. Household pays \$200 and the assistance pays \$400; the total rent is \$600. There is no noncompliance since the household portion of rent is below the maximum LIHC rent allowed.

The portion of the rent paid by Section 8 tenants can exceed the LIHC rent ceiling as long as the owner receives a Section 8 assistance payment on behalf of the resident. If no subsidy is provided, the tenant may not pay more than the LIHC rent ceiling.

Example 2: Tenant's Portion of Rent Exceeds Rent Limit

A Section 8 household with an annual income of \$18,000 applies for an LIHC unit for which the rent is restricted to \$500 and for which the market rate rent is \$750. Assistance will pay a maximum of \$500, and the applicant's portion is \$600 (40 percent of income). Since the applicant is required to pay \$600, Section 8 will pay \$150. There is no noncompliance.

Note: This example reflects HUD's requirement under the Section 8 housing choice program. The family share may not exceed 40 percent of the family's share monthly adjusted income when the family initially moves into the unit or signs the first assisted lease for a unit. Additional information available at www.hudclips.org/sub_nonhud/jtml/pdfforms/7420g06.pdf.

Rural Development (FmHA) Rents

Originally, the rent restrictions for projects with Rural Development assistance were computed using the general rules for LIHC housing. Beginning in 1991, however, gross rent does not include any rental payment to the owner of the unit to the extent such owner pays an equivalent amount to the USDA Rural Housing Service⁸ under section 515 of the Housing Act of 1949. See IRC §42 (g)(2)(B)(iv). In other words, as long as the owner pays Rural Development the rent amount over the limit (all of the overage) that unit is in compliance.

Example 1: Rent Above Limit (Owner Pays Rural Development, formerly known as FmHA)

Assume a 1991 credit allocation to a property with Rural Development assistance. The maximum gross LIHC rent is \$500 and the household's calculated rent under Rural Development regulations is \$650, which the owner charges. The owner provides documentation that the \$150 above the tax credit maximum has been remitted directly to Rural Development. There is no noncompliance.

Supportive Services

After 1989, gross rent does not include any fee for a supportive service paid to the owner by any governmental program or tax-exempt organization if the amounts paid for rent and assistance are not separable.⁹ Under Treas. Reg. §1.42-11, supportive services mean any service designed to enable residents to be independent and avoid placement in a hospital, nursing home, or intermediate care facility for the mentally or physically

⁸ Formerly known as the Farmer's Home Administration.

⁹ IRC §42(g)(2)(B)(iii) and Revenue Reconciliation Act of 1989.

handicapped. Examples of supportive services include transportation, housekeeping, or planned social activities. Supportive services do not include continual or frequent nursing, medical, or psychiatric services.

Example 1: 1990 Credit Allocation

Assume a 1990 credit allocation. The maximum gross rent is \$500 and the owner receives a monthly payment of \$600 from a tax-exempt organization to assist the household with the living expense of handicapped persons so that such persons can live independently and avoid placement in a hospital. There is no noncompliance as long as the owner provides documentation that the assistance is inseparable from the rental of the unit and complies with above rule.

Deep Rent Skewing

Under IRC §142(d)(4)(B)¹⁰, an owner can elect to provide housing to households with incomes of 40% or less of the Area Median Gross Income (AMGI). The election is made on Form 8609, Low-Income Housing Certification, line 10d. The project qualifies if:

1. 15 percent or more of the low-income units are occupied by individuals whose income is 40 percent or less of the AMGI;
2. The gross rent with respect to each low-income unit in the project does not exceed 30 percent of the applicable income limit which applies to the individuals occupying the unit; and
3. The gross rent with respect to each low-income unit in the project does not exceed ½ of the average gross rent with respect to units of comparable size that are not occupied by individuals who meet the applicable income limit.

Assistance Provided Under the HOME Investment Partnership Act

IRC §42(i)(2)(E)(i) generally provides that assistance provided under the HOME Investment Partnerships Act (HOME) with respect to any building will not be treated as a below market Federal loan if 40 percent or more of the residential units *in the building* are occupied by individuals whose income is 50 percent or less of the Average Median Gross Income (AMGI). The rent restriction for all the low-income units, including the units used to satisfy the rules under IRC §42(i)(2)(E)(i), is based on the applicable income limitation under IRC §42(g). See Rev. Rul. 2004-82, Q&A #6.

In Compliance

A unit is in compliance when the rent charged does not exceed the limitations.

Example 1: Provision of Optional Services

An LIHC property provides hot meals twice a day for the convenience

¹⁰ IRC §42(g)(4) authorizes the application of deep rent skewing under IRC §142(d)(4)(B) for IRC §42 properties.

of its tenants in a common dining facility. They charge a nominal fee to cover their costs, but do not include the cost in the rent charged for the apartments. Each unit in the property includes a fully functional kitchen.

In this case, a practical alternative exists for tenants to obtain meals other than from the dining facility, and payment for the meals in the common dining facility is not required as a condition of occupancy. Thus, the cost of the meals is not included in gross rent for purposes of IRC §42(g)(2)(A) and Treas. Reg. §1.42-11(b).

Example 2: Fee for Late Payment of Rent

A tenant pays the maximum rent of \$525 for a one bedroom unit. The tenant did not pay the rent timely and was charged a late fee of \$35, as stated in the lease.

The \$35 late is a penalty for failure to perform according to the lease agreement and, therefore, the fee is not included in the rent.

Out of Compliance

A unit is out of compliance when the rent charged exceeds the limitation.

1. If the noncompliance is the result of noncompliance with the utility allowance requirements, the error should be noted under category 11m, Owner did not properly calculate utility allowance.
2. If the noncompliance is the result of a systemic error, also evaluate whether the minimum set-aside under IRC §42(g)(1) was met. See chapter 9.

Example 1: Tenant Income Rises Above Limit

A household was initially income qualified and moved into a unit on 1/1/2000. The maximum LIHC gross rent is \$500. At recertification, the owner increased the rent to the market rate of \$1,000.

The unit is out of compliance, beginning on the date the rent was increased above the maximum of \$500.

Back in Compliance

A unit is back in compliance when the rent charged does not exceed the limit. An owner cannot avoid the disallowance of the LIHC by rebating excess rent to the affected tenants.

Example 1: Overcharged Rent

The owner leased the minimum number or units to IRC §42 eligible tenants during the third year of the credit period. However, the owner inadvertently overcharged rent to tenants occupying 3 bedroom apartments. The error impacted 15 out of 75 units.

The unit is back in compliance when the owner correctly limits the rent for all units.

Example 2: Overcharged Rent Impacted Minimum Set-Aside

The owner leased the rental units in a 100% LIHC building to IRC §42 eligible tenants by the end of the first year of the credit period. However, the owner overcharged rent for all the units and, as a result, failed to meet the minimum set-aside for the first year of the credit period.

The building does not qualify for LIHC.

References

1. Rev. Rul. 91-38, 1991-2 C.B. 3.
2. Rev. Rul. 98-47, 1998-2 C.B. 399.
3. Rev. Rul. 2004-82, 2004-35 I.R.B 350.